

# IMPACTS OF HIGH MOTOR FUEL PRICES ON AGENCIES

A Report Prepared for the

## **Legislative Finance Committee**

By  
Greg DeWitt

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**Legislative Fiscal Division**



[www.leg.state.mt.us/css/fiscal/](http://www.leg.state.mt.us/css/fiscal/)

## **PURPOSE OF REPORT**

This report provides information to the Legislative Finance Committee to help them better understand the potential directions and impacts of changes in fuel<sup>1</sup> prices on state government expenditures and operations. The report also sets the stage for further reports as developments occur and more is known.

## **GETTING FUEL TO AGENCY USERS**

### **HOW DO MONTANA STATE GOVERNMENT MOTOR VEHICLE USERS ACQUIRE FUEL?**

#### **Non-bulk Fuel Purchase**

With exceptions in the Department of Transportation (DOT), fuel for state agencies' vehicles or vehicles rented from the State Motor Pool is purchased primarily via the retail market, through local gas stations and convenience stores. Fuel is purchased by way of a fueling card (like a credit card) administered through a private enterprise under contract with the state<sup>2</sup>. Most state agencies participate in the fueling card program. The fueling card can only be used to purchase vehicle fuel. One fueling card is assigned to each state vehicle.

#### **Bulk Fuel Purchase**

In addition to purchasing fuel from the retail market, DOT also purchases vehicle fuel via a bulk purchase contract at department facilities across the state. Of the DOT bulk fuel sites, fuel is dispensed from 14 sites through the fueling card network with transactions administered by the fueling card vendor. For all other bulk fuel sites DOT administers fuel consumption by recording fuel usage by vehicle and billing the program responsible for paying fuel costs. In DOT, either the State Motor Pool or the Equipment Program owns most vehicles, and are funded with internal services funds through fees for vehicle and equipment usage. The State Motor Pool and Equipment Program are responsible for paying fuel costs for all vehicles of the respective program. Fuel costs are recovered through the rates charged for use of the vehicles supplied by the program.

### **HOW IS THE MOTOR FUEL USED BY MONTANA STATE GOVERNMENT PAID FOR?**

#### **Fueling Card at Non-bulk Sites**

The fueling card vendor administers fuel purchases made via the fueling card network and purchased from a private gas station or convenience store. The fueling card vendor pays full retail price less a retailer-paid transaction fee and the per-gallon federal fuel tax of \$0.184 for gasoline or \$0.244 for diesel fuel. The fueling card vendor bills the agency owning the vehicle for the retail cost of the fuel at the time of purchase less the applicable federal fuel tax. If the fuel was purchased for a vehicle rented or leased by a state agency from the State Motor Pool, the State Motor Pool is billed for the fuel. The State

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<sup>1</sup> Fuel is defined as gasoline and diesel fuels for motor vehicles and natural gas for facilities.

<sup>2</sup> The current fueling card contract with Wright Express will have existed for seven years at the time it expires in January 2006. Under the contract, there is not cost to the state for Wright Express to provide the fueling cards and administer the financial transactions for paying retailers and billing state agencies. The only cost of the program to state agencies above the cost of purchased fuel is a 0.5 percent markup on agencies' gross fuel purchases. The markup funds Department of Administration activities to administer the fueling card contract.

Motor Pool recovers vehicle fuel costs through the vehicle rental fee charged for usage of State Motor Pool owned vehicles.

## **Bulk Fuel Sites**

Fuel purchased for DOT bulk sites is purchased from the wholesale market at a cost lower than fuel purchased from retail vendors. The contract provisions differ among bulk sites based on the contracted vendor. In addition to contract provisions, bulk sites differ depending on whether the site is administered as a part of the fueling card network. In FY 2005, bulk gasoline purchased for State Motor Pool vehicles averaged \$0.09 per gallon less than fuel purchased from retail sites. However, bulk fuel accounted for only 22 percent of State Motor Pool fuel consumption. FY 2005 average Equipment Program bulk fuel cost \$0.21 for gasoline and \$0.42 for diesel less per gallon than fuel purchased from retail. Bulk purchased fuel comprised 25 percent of gasoline purchases and 64 percent of diesel purchases for the Equipment Program.

Bulk fuel is purchased at the rack price (price at the wholesale distribution terminal) plus state fuel taxes, fees, and vendor markup. Vendor markup is charged for vendor administration, distribution costs, and profit. Bulk vendor markup is at a wholesale level because retail overhead and profits are removed from the distribution chain. For the 14 bulk sites on the fueling card network, DOT pays an additional \$0.12 per transaction to Wright Express for administering the purchases.

## **HOW DOES FUEL GET USED**

State agencies travel for various reasons such as:

- Travel to directly perform the functions of the agency
- Travel to attend meetings (management or public involvement)
- Travel for training

When traveling via motor vehicle, agencies use vehicles owned by the agency or rented from the State Motor Pool. When the agency owns the vehicle motor fuel is paid directly by the agency. The 10 agencies with the highest gasoline costs in FY 2005 are listed in Figure 1.

Figure 1 FY 2005 Gasoline Purchases 10 Agencies with the Highest Expenditures			
Agency	FY 2005 Amount	Percent of Top 10	Percent of All Agencies
5401 Department Of Transportation	\$3,033,546	48.5%	46.5%
5201 Dept Of Fish, Wildlife & Parks	933,111	14.9%	14.3%
4110 Department Of Justice	789,702	12.6%	12.1%
5102 Commissioner Of Higher Education	589,773	9.4%	9.0%
5706 Dept Nat Resource/Conservation	305,312	4.9%	4.7%
6401 Dept. Of Corrections	163,848	2.6%	2.5%
6602 Labor & Industry	150,740	2.4%	2.3%
5603 Department Of Livestock	116,891	1.9%	1.8%
6901 Public Health & Human Services	100,373	1.6%	1.5%
3101 Governors Office	66,171	1.1%	1.0%
Top 10 total	<u>\$6,249,467</u>		95.8%
Total of all agencies	\$6,521,431		

Figure 1 shows that gasoline expenditures for the top 10 agencies comprised 96 percent of FY 2005 expenditures for gasoline. The Department of Transportation is listed as the agency with the highest gasoline purchases at nearly half of all gasoline purchased in state government.

Diesel fuel purchases totaled \$2.7 million in FY 2005 with five agencies<sup>3</sup> accounting for nearly all of the purchases. Again, DOT was the highest user, with the Equipment Program accounting for all diesel fuel purchases of the department.

A breakdown of gasoline expenditures by DOT indicates that the State Motor Pool (\$1.1 million or 36.8 percent of department gasoline purchases) and the Equipment Program (\$1.8 million or 60.6 percent of department gasoline purchases) make up 97.4 percent of all department gasoline expenditures. The State Motor Pool purchases all fuel for vehicles rented or leased to state agencies by the program. Likewise, the Equipment Program purchases all fuel for program vehicles rented to other programs of DOT. Figure 2 lists the 10 agencies that spent the most in FY 2005 to rent vehicles from the State Motor Pool. The figure shows that the 10 highest users comprise 92.3 percent of all State Motor Pool users.

<sup>3</sup> Department of Transportation, (\$2,456,280), Department of Corrections (\$111,704), Fish, Wildlife & Parks (\$48,829), Commissioner of Higher Education (\$48,685), and Department of Public Health and Human Services (\$32,450)

**Figure 2**  
**FY 2005 Payments to State Motor Pool**  
**10 Agencies with the Highest Expenditures**

Agency	FY 2005 Amount	Percent of Top 10	Percent of All Agencies	Daily Rental Rank	Lease Rank
5201 Dept Of Fish, Wildlife & Parks	\$2,127,765	40.2%	37.1%	1	8
6901 Public Health & Human Services	764,023	14.4%	13.3%	3	2
6401 Dept. Of Corrections	614,664	11.6%	10.7%	33	1
5706 Dept Nat Resource/Conservation	427,719	8.1%	7.5%	10	3
5801 Department Of Revenue	414,985	7.8%	7.2%	16	4
6602 Labor & Industry	286,636	5.4%	5.0%	6	5
5401 Department Of Transportation	230,716	4.4%	4.0%	2	N/A
5301 Dept Of Environmental Quality	216,589	4.1%	3.8%	8	6
4110 Department Of Justice	125,512	2.4%	2.2%	19	7
5603 Department Of Livestock	<u>81,031</u>	1.5%	<u>1.4%</u>	29	9
Top 10 total	<u>\$5,289,640</u>		92.3%		
Total of all agencies	\$5,729,995				
<u>Rental program</u>					
Lease	\$2,926,052				
Daily rentals	\$2,803,942				

Further work is needed to breakout agency functions according to the various travel categories listed above. However, some examples of travel that would fall within the category of travel to directly perform the functions of the agency include:

- Inspect nursing homes for compliance to certification standards
- Investigate child protection issues and complaints
- Examine banking institutions
- Inspect highway construction projects
- Inspect meat-processing facilities
- Patrol state highways
- Transport individuals convicted of crime to detention facilities

For future meetings, agency functions will be reviewed and more quantitative information will be provided for the various travel categories.

## **HOW DO CHANGES IN MOTOR FUEL COSTS MANIFEST THEMSELVES TO AGENCIES**

### **Who Bears the Direct Risk From Higher Fuel Costs?**

The agency owning the vehicle assumes the risk from budgeting for rising fuel costs. For vehicles owned by the State Motor Pool, the State Motor Pool pays for fuel and recovers costs through a rental rate based on vehicle miles driven by the user. State law caps the rates charged by the State Motor Pool at the levels approved by the legislature. If fuel costs increase above the levels anticipated in the rate structure, the State Motor Pool is restricted from raising rates above those published in HB 2 and must either control costs in other areas of operations or borrow funds to finance fuel purchases. Because the State Motor Pool is funded with an internal service type proprietary fund, the rates for the next biennium

would include a component to repay debt, so the fees of the fund are commensurate with costs. Since State Motor Pool rates are capped at the legislative levels, agencies that use the State Motor Pool would not see a direct budgetary impact of rising fuel costs during the current biennium under previously anticipated travel plans. As such, they would have no short-term budget pressures to restrict travel. However, funding deficits in State Motor Pool funding, due to capped rental rates and high fuel costs, would materialize in higher rental rates requested of the following legislature.

The Governor has instructed Executive Branch agencies to scrutinize travel and to conserve motor fuel consumption through steps such as car-pooling. DOT has been charged with developing a process to facilitate the exchange of information to enhance car-pooling and to monitor agency vehicle usage patterns. Agencies have been instructed to take steps to live within their 2007 biennium travel budgets.

In August 2004, when agencies were developing their budget requests for the 2005 Legislature, the retail price for gasoline in Montana was \$2.05 per gallon. Gasoline price increases were not generally anticipated and there was no general inflation adjustment for gasoline. The only budget increases for gasoline over the FY 2004 base expenditures were for adjustments justified in separate budget decision packages. Budget increases through decision packages for FY 2006 totaled \$350,000 for all agencies, with two-thirds of the increases for State Motor Pool and Equipment Program fuel costs. Generally, these two programs of DOT assumed a 5 percent increase over base expenditures. So, agencies will be faced with motor fuel costs that are currently about 46 percent higher than anticipated and projected settle at about 22 percent higher than anticipated through the remainder of the biennium.

## **HOW WERE MOTOR FUEL EXPENDITURES FUNDED**

In FY 2005 state government paid about \$9.2 million for motor fuel (gasoline and diesel fuel). Motor fuel purchases are paid for in two ways:

- Directly by the end user agency
- Indirectly by the end user agency through vehicle rental fees

An examination of FY 2005 expenditures for gasoline and diesel fuel, after adjusting for gasoline purchased by the two largest motor fuel user proprietary funded service programs, the State Motor Pool and Equipment Program of DOT, to reflect the funding profile for payments made to these service programs, shows the following approximate fund breakdown:

- General fund (9 percent or \$0.8 million)
- State special revenue (59 percent or \$5.5 million)
- Federal special revenue (11 percent or \$1.0 million)
- Other fund (20 percent or \$1.9 million)

## **COMPONENTS OF RETAIL MOTOR FUEL PRICE**

As of October 3, 2005, motor fuel retail prices in the Rocky Mountain Region<sup>4</sup> of the United States and the components of the price were as shown on Figure 3. These prices reflect per-gallon increases of \$.003 for gasoline and \$0.14 for diesel over the previous weeks prices. Compared to one year ago, per-gallon prices are now higher by \$0.96 for gasoline and \$1.01 for diesel.

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<sup>4</sup> The Rocky Mountain Region includes the states of: Montana, Idaho, Wyoming, Utah, and Colorado

**Figure 3**  
**Components of Retail Motor Fuel Price**  
(October 3, 2005)

Price Component	<u>Gasoline</u>		<u>Diesel</u>	
	Percent of Price	Amount	Percent of Price	Amount
Crude Oil Price	56%	\$1.62	56%	\$1.72
Refining	24%	0.69	20%	0.61
Distribution and Marketing	2%	0.06	4%	0.12
Taxes	18%	<u>0.52</u>	20%	<u>0.61</u>
Total Price (Rocky Mountain Region)		\$2.89		\$3.07

Source: Energy Information Administration, U.S. Department of Energy, Gasoline and Diesel Fuel Update (U.S. Gasoline and Diesel Fuel Prices, 10/03/05)

## FACTORS FOR RECENT MOTOR FUEL PRICE INCREASE

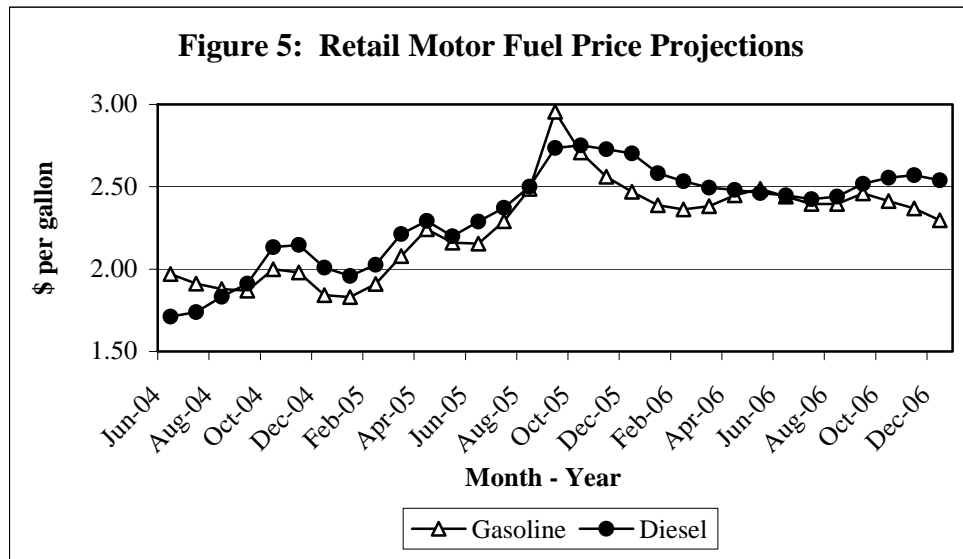
From September 23, 2004, to September 24, 2005 (latest data available), spot market prices for crude oil grew from \$47.50 to \$63.42 per barrel. Based on the percentage of retail prices that crude oil prices influence and the changes in retail price that actually took place, Figure 4 suggests that other factors besides just crude oil price contributed to the motor fuel price growth seen recently. According to the predictions shown on Figure 4, only about one-third of the retail price change can be explained by crude oil price changes. The remaining change in retail price is suspected to be due to market reactions to fuel supply, storage, and distribution issues following Hurricanes Katrina and Rita.

**Figure 4**  
**Predicted Retail Motor Fuel Costs Due to Crude Oil Price Change**

Date of Price Quote	<u>Spot Market (barrel)</u>			<u>Retail Price (gallon)</u>	
	WTI - cushing	Brent	Average	Gasoline	Diesel
9/23/2005	\$64.67	\$62.17	\$63.42	\$2.86	\$2.94
9/24/2004	48.86	46.13	47.50	1.90	2.00
Growth amount (actual)			15.93	0.96	0.94
Growth percentage (actual)			33.5%	50.7%	47.0%
Motor fuel component percentage			56.0%		
Motor fuel component increase (for actual)			18.8%		
Predicted price on 9/23/05				\$2.25	\$2.37
Difference of actual over predicted				\$0.61	\$0.56

## SHORT-TERM OUTLOOK FOR MOTOR FUEL PRICES

According to projections in the August 2005 Short-term Energy Outlook published by the Energy Information Administration of the U.S. Department of Energy, national average retail prices for motor fuel may be at a high point and are projected to drop to below \$2.50 per gallon near the beginning of 2006, as shown on Figure 5. If the predictions hold true, prices for motor fuel could soften but still be nearly 20 percent higher than funded in agency budgets for the current biennium.



## FUTURE MONITORING

For future committee meetings motor fuel prices will be monitored and trends reported to the committee. More quantitative data will be compiled to identify budget impacts on agency functions from high motor fuel costs. The processes currently being developed in the executive to mitigate the impacts of high motor fuel costs will be monitored and the committee updated as appropriate.